KUTHUBUL ZAMAN BUKHARI & ANOR A

v.

TSAI SU CHU & ORS

HIGH COURT MALAYA, JOHOR BAHRU B
GUNALAN MUNIANDY JC
[CIVIL SUIT NO: 23-46-2010]
24 OCTOBER 2012

COMPANY LAW: *Directors - Recovery of debt against director - Judgment debt - Dissipation of company's assets and funds before court delivered its decision - Whether done with fraudulent intention to defraud plaintiffs - Whether sequence of events to be viewed in its totality - Whether disposal of assets detrimental to and jeopardised financial standing of company - Whether directors personally liable to settle judgment debt owed by company - Companies Act 1965, s. 304* C D

In the Sessions Court, the plaintiffs had obtained a judgment against the ninth defendant company ('D9') for a sum exceeding RM250,000. D9, through its solicitors, had paid the judgment sum to the plaintiffs' solicitors. On appeal by D9, the High Court allowed its appeal and the plaintiffs, through their solicitors, returned the judgment sum to D9's solicitors. Thereafter, the plaintiffs filed an appeal to the Court of Appeal and the appeal was granted in their favour. However, the plaintiffs were unable to enforce the judgment against D9 as it was alleged that D9's directors, *ie*, the first to the eighth defendants ('D1-D8') had unlawfully dissipated the company's assets to deprive the plaintiffs from receiving the judgment sum. Subsequently, the claim against D3 was withdrawn. The plaintiffs filed this suit based on the provision of s. 304 of the Companies Act 1965 ('the Act') to recover the judgment sum from the remaining defendants. The plaintiffs' claim was based on the passing of a directors' resolution and a shareholders' resolution ('resolutions') which authorised a transfer of RM2.4 million of D9's assets to D2, purportedly to invest in a business which was alleged to be totally unrelated to the objects of the company. On the contrary, the defendants alleged that the plaintiffs were not judgment creditors as there was only a pending appeal at the Court of Appeal and no subsisting judgment was in their favour. The issue that arose for determination was whether the dissipation of D9's assets that E F G H I

occurred before the Court of Appeal's decision was done with intent to defraud the plaintiffs by depriving them of what could become due to them.

Held (allowing plaintiffs' claim):

(1) The manner in which the assets of D9 were dissipated within a short span of time called into question the motive behind the move. There was no plausible reason to deal with the remaining assets and funds of D9 in such a suspicious manner other than to deprive the plaintiffs of any claim that may arise in due course. Hence, the act of dissipation by leaving no assets or funds to satisfy the claim at that point in time could be considered as wilful and intentional. The sequence of events had to be viewed in its totality (*Rahj Kamal Abdullah v. PP*; refd). (para 12)

(2) On the date of the resolutions, D6, D7 and D8 had not been appointed yet as directors of D9. D6 and D7 were appointed as directors some four months after the resolutions whereas D8 was appointed even later. Apart from this fact, there was no evidence that these defendants had participated in any fraudulent dissipation of assets and funds at the material time. The allegations against D6, D7 and D8 had not been proved and thus, they could not be held liable to compensate the plaintiffs for the losses they had suffered. On the other hand, D4 was not involved in signing the impugned resolutions and there was no other evidence implicating him. Hence, the allegation of fraud had not been proved against D4 and he too could not be held liable for the losses suffered by the plaintiffs. (paras 16 & 17)

(3) The alleged fraud concerned was of a civil nature and the civil standard of proof would apply. The plaintiffs had proven their case against D1, D2 and D5 under s. 304(1) of the Act for carrying on the business of the company with the intent to defraud its creditors. D1 and D5, who were husband and wife, together with D2, were the majority shareholders who had passed the resolutions. As the majority shareholders at the material time, they controlled both the company and the board of directors. All decisions seemed to be in their hands. The sequence of events, particularly the timing of the

resolutions and the disposal of assets, pointed to the acts being done with fraudulent intention and were certainly detrimental to and jeopardised the financial standing of D9. Hence, they were personally liable to the plaintiffs to settle the judgment debt owed to the plaintiffs by D9. (paras 14, 18, 19, & 20)

Case(s) referred to:
Ang Hiok Seng v. Yim Yut Kiu [1997] 1 CLJ 497 FC ***(refd)***
Rahj Kamal Abdullah v. PP [1998] 1 SLR 447 ***(refd)***
Siow Yoon Keong v. H Rosen Engineering BV [2003] 4 CLJ 68 CA ***(refd)***
Walker v. Wimborne & Ors [1975] 3 ACLR 529 ***(refd)***
Winkworth v. Edward Baron Development Co Ltd & Others [1987] 1 All ER 114 ***(refd)***

Legislation referred to:
Companies Act 1965, s. 304(1)
Evidence Act 1950, s. 102

For the plaintiffs - John Fernandez; M/s R Muthu & Co
For the 1st, 3rd, 4th, 5th, 6th & 7th defendants - KS Pang (WC Teo with him); M/s KS Pang & Co
For the 8th & 9th defendants - KF Hua; M/s KF Hua & Partners

Reported by Kumitha Abd Majid

JUDGMENT

Gunalan Muniandy JC:

Factual Background

[1] The plaintiff ('P') obtained judgment against the ninth defendant company ('D9') at the Sessions Court for a sum exceeding RM250,000 inclusive of costs and interest. D9, through its solicitors, paid the judgment sum to P's solicitors. On appeal by D9, the High Court allowed the appeal with costs. P, through their solicitors then returned the judgment sum to D9's solicitors. Thereafter, P filed an appeal against the decision of the High Court to the Court of Appeal. P were successful in the appeal. The Court of Appeal allowed the appeal, set aside the decision of the High Court and upheld the judgment of the Sessions Court dated 17 February 2003. However, P were unable to enforce the judgment against D9 due to the allegedly deliberate acts of its

directors (defendants 1 - 8) in unlawfully dissipating the company's assets to deprive P of the judgment sum. Hence, this suit against defendants 1 - 8 ('D1 - D8') for several declarations and orders basically to recover the judgment sum from them. The assets and funds of D9 had already been disposed of pending appeal to the Court of Appeal.

[2] The claim against D3 was withdrawn with no order as to costs.

Basis Of Claim

[3] P's suit was based on the provisions of s. 304, Companies Act 1965 ('CA') which read as follows:

> ... If in the course of the winding up a company or in any proceedings against a company it appears that any business of the company has been carried on with intent to defraud creditors of the company or creditors of any other person or for any fraudulent purpose, the Court on the application of the liquidator or any creditor or contributory of the company may if it thinks proper so to do declare that any person who was knowingly a party to the carrying on of the business in that manner shall be personally responsible, without any limitation of liability, for all or any of the debts or other liabilities of the company as the Court directs.

[4] The issue before the court was simply whether the alleged acts of D9's directors in dissipating D9's assets pending appeal to the Court of Appeal could be construed as "with intent to defraud creditors of D9." P were purportedly judgment creditors in this case based on the judgment of the Sessions Court despite the judgment being reversed by the High Court. The basis of the contention was that at this stage the dispute was still pending final determination by the Court of Appeal.

[5] The crux of P's case was the passing of a directors' resolution and a shareholders' resolution both dated 30 March 2009 authorising transfer of RM2.4 million of D9's assets to D2 purportedly to invest in a business which was alleged to be totally unrelated to the objects of the company.

[6] Before the Court of Appeal disposed of the appeal from the High Court on 28 July 2009, the defendants who were directors and shareholders of D9 at the material time were alleged to have

proceeded to dissipate its assets and funds by the passing of the above resolutions (exh. D1 and D2). The funds amounting to RM2.4 million were transferred to D2, one of the directors. The said amount is reflected as a loan in the company's balance sheet for financial year ending 31 December 2009.

[7] Having allegedly dissipated the assets and funds of D9, the record showed that D1, D2 and D4 resigned as its directors from 23 July 2009. D2 remained a shareholder of D9. It was alleged that the actions were unlawful and the combined effect was to leave D9 with no assets to satisfy the judgment that the plaintiffs obtained after the decision of the Court of Appeal. The purported loan to D2 was said to reflect a clear intention not to repay the judgment sum to the plaintiffs as the transfer of funds took place just in time before the Court of Appeal could deliver its decision.

[8] P also referred to the fact that all funds and inventories of D9 had been transferred to three unrelated entities. This was confirmed by PW1, the auditor who prepared D9's financial report. Inventories totalling RM500,000 were shown to have been wiped out during the accounting year ending 31 December 2009. It was alleged that these transactions were unlawful and designed to move the assets of D9 out of the court's jurisdiction. Evidence showed that D2 who had taken the loan of RM2.4 million had his business in Hainan, China and Thailand. According to P, D1 - D7 as directors of D9 had a duty to ensure that the company was properly administered and its interests protected. Reference was made to *Winkworth v. Edward Baron Development Co Ltd & Others* [1987] 1 All ER 114 which held:

> The conscience of the company, as well as its management, is confided to its directors. A duty is owed by the directors to the company and to the creditors of the company to ensure that the affairs of the company are properly administered and that its property is not dissipated or exploited for the benefit of the directors themselves to the prejudice of the creditors.

[9] In essence, P's case was that the loan to D2 and the above dissipation of D9's inventories and assets were all deliberate and by design "with intent to defraud creditors of the company ... or for any fraudulent purpose" (s. 304(1) CA). The creditors in the instant case were the plaintiffs who had prospects of succeeding in the Court of Appeal against the High Court decision to dismiss

their claim. The timing of the said wrongful acts by the relevant directors/shareholders of D9 while the case was pending before the Court of Appeal allegedly revealed an intention to defraud P. Reference was made to the Court of Appeal case of *Siow Yoon Keong v. H Rosen Engineering BV* [2003] 4 CLJ 68; [2003] 5 AMR 735 which held:

> Next we come to the phrase "with intent to defraud creditors ... or for any fraudulent purpose". First, we would like to note that the phrase should be read disjunctively even though on the facts of the case both limbs are relevant and applicable.

[10] The crux of the defence case was that at the material time of the alleged fraudulent acts P were not judgment creditors as there was only a pending appeal at the Court of Appeal and no subsisting judgment in their favours. As such, there was then no debt owed by D9 to P who, thus, could not be considered creditors of D9 until the Court of Appeal reversed the High Court decision.

Issues To Be Determined

[11] This case can be decided by determining the following core issues:

(a) Whether the dissipation of D9's assets that occurred before the Court of Appeal decision was with intent to defraud the plaintiffs ('P') by depriving them of what could become due to them?

(b) If the above is in the affirmative could D1, D2 and D4 - D8 be held collectively and personally liable for the alleged fraudulent acts irrespective of their role in the said acts?

Findings On Issues

[12] It was not in dispute that after the Court of Appeal decided in favour of P, D9 was left with no assets and funds to pay the debt owed to P. As pointed out by P, D9 had not faced any downturn in its business or ceased operations. However, the manner in which the assets totalling RM2,900,000 (cash of RM2,400,000 and inventory stock of RM500,000) were dissipated within a short span of time called into question the motive behind the move. There was no plausible reason to deal with the

remaining assets and funds of D9 in such a suspicious manner other than to deprive P of any claim that may arise in due course. D9 was fully aware of the amount claimed by P which is reflected in its balance sheet for financial year ending 31 December 2009 as litigation claims. Hence, the act of dissipation leaving no assets or funds to satisfy the claim at that point in time could be considered as wilful and intentional. Granted that at the material time of the alleged wrongful acts, there was no judgment debt against D9 following the High Court decision. However, this fact cannot be viewed in isolation. The sequence of events has to be viewed in its totality. Intention is not a matter that can be proved by direct evidence but to be inferred from all the surrounding circumstances. As held in *Rahj Kamal Abdullah v. PP* [1998] 1 SLR 447:

> ... dishonesty could have been inferred from the surrounding circumstances and the subsequent conduct of the appellant, especially the concealment of material facts.

[13] Based on the circumstances viewed in their totality, it would be safe to infer that the transfer of funds and dissipation of assets adverted to were done intentionally to defraud P of their claim. The effect of the wrongful acts was that D9 was placed in a position that it was unable to satisfy the claim of P. The burden of proof on a plaintiff who alleges fraud is no doubt high and the standard of proof is beyond reasonable doubt where criminal fraud is alleged. In the Federal Court case of *Ang Hiok Seng v. Yim Yut Kiu* [1997] 1 CLJ 497, it was held (per Mohd Azmi FCJ):

> Where the allegation of fraud in civil proceedings concerns criminal fraud such as conspiracy to defraud, or misappropriation of money or criminal breach of trust, it is settled law that the burden of proof is the criminal standard of proof beyond reasonable doubt, and not on a balance of probabilities. However, where the allegation is entirely founded on a civil fraud and not on a criminal conduct or offence, the civil burden is applicable.

[14] In the instant case, the alleged fraud by the defendants concerned was of a civil nature perpetrated to deny P of the fruits of their litigation. There was no serious allegation amounting to criminal conduct on the part of the said defendants. Hence, the civil standard of proof would apply. I found that there was sufficient evidence of the defendants concerned having acted with

an intention to defraud P as alleged in the sense that they ensured that D9 would not be able to satisfy the said judgment debt.

[15] Coming now to the question of whether all the defendants, with the exception of D3, could be held liable, it is first important to consider the date of the impugned board and shareholders, resolutions. It was through these resolutions dated 30 March 2009 that the advance of RM2.4 million to D2 was sanctioned.

[16] On the date of the above resolutions, D6, D7 and D8 had not been appointed yet as directors of D9. D6 and D7 were appointed as directors some four months after the resolutions whereas D8 was appointed even later, ie, some seven - eight months thereafter. Apart from this fact, there was no evidence that these defendants had participated in any fraudulent dissipation of assets and funds at the material time. Granted that, as contended by P, these defendants, who could be presumed to be aware of the said fraudulent acts and were able to prevent or expose the same, had chosen to concur with or condone the acts. They were alleged to have done so knowingly with a view to deriving a benefit from those acts. However, I did not agree that this inaction would tantamount to participation in the fraudulent acts. The burden of proof of fraud as alleged is on P. (s. 102 of the Evidence Act 1950). I, therefore, held that, on the above evidence, the allegations against D6, D7 and D8 as pleaded had not been proved and they could not be held liable to compensate P for the losses that P had suffered.

[17] With respect to D4, the record shows that he was not involved in signing the impugned resolutions. He testified that he did not sign the board resolution because he did not agree with it. As for the shareholders, resolution, he did not sign it because he was never a shareholder of D9 and thus, had no right to do so. The evidence of D4 was unchallenged and undisputed. It was submitted that this evidence must therefore be deemed to be admitted. The fact that D4 resigned as director along with D1 and D2 on 23 July 2009 after the funds and assets had been dissipated did not, in my view, make a significant difference. From this fact alone it cannot be presumed that he too had participated in the fraudulent acts. There was no other evidence implicating him in these acts. For these reasons, I found that the allegation of fraud as pleaded had not been proved against D4 and he too could not held liable for the losses suffered by P.

[18] It was undisputed that D1 and D5, who were husband and wife, together with D2 were the majority shareholders who had passed the impugned resolutions. As the majority shareholders at the material time, they controlled both the company and the board of directors. All decisions seemed to be in their hands. D5 in his evidence conceded that apart from D1, D2 and himself who signed the impugned resolutions no other directors were involved in making decisions on the company's funds and assets.

Conclusion

[19] Counsel for D1 - D7 contended that that resolutions passed by D1, D2 and D5 to advance RM2.4 million to D was *bona fide* for the purpose of investment and not fraudulent to deprive the creditors of D9 of what was rightly due to them. However, as adverted to, the evidence clearly disclosed that this was not so. The sequence of events, particularly the timing of the resolutions and the disposal of assets, pointed without doubt to the acts being done with a fraudulent intention as alleged by P. They were certainly detrimental to and jeopardised the financial standing of D9. As held in the case of *Walker v. Wimborne & Ors* [1976] 3 ACLR 529:

> The transaction offered no prospect of advantage to Asiatic, it exposed Asiatic to the probable prospect of substantial loss, and thereby seriously prejudiced the unsecured creditors of Asiatic. It was more than an improvident transaction reflecting an error of judgment; it was undertaken in accordance with a policy adopted by the directors in total disregard of the interests of the company and its creditors ...

[20] By reason of the foregoing, I held that the plaintiffs had proven their case against defendants 1, 2 and 5 under s. 304(1) CA for carrying on the business of the company with an intent to defraud its creditors. I, therefore, held them personally liable to the plaintiffs to settle the judgment debt owed to the plaintiffs by the company (D9). The prayers for the declarations sought were also granted against these defendants.